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Supreme Court of the United States.

OCTOBER TERM, 1967.

No. 633

CROSBY VALVE & GAGE COMPANY
(Formerly Crosby Steam Gage & Valve Company),
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI.

MATTHEW BROWN,
85 Devonshire Street,
Boston, Massachusetts 02109,
Attorney for Petitioner.

ALFORD P. RUDNICK,
JACK H. CALMCHMAN,
PETER D. GENS,
Of Counsel.

ALDEN-O. BROWN & CO. INC., LAW PRINTERS, BOSTON.

Table of Contents.

Opinions below	1
Jurisdiction	2
Question presented	2
Statutes and rules involved	2
Statement of the case	2
Reasons for granting the writ	3
Summary of argument	4
Argument	5
I.	5
II.	6
III.	8
IV.	9
Conclusion	10
Appendix A	11
Internal Revenue Code of 1954	11
Section 170(a)	11
Section 170(b) (2)	11
Section 301(a)	12
Section 301(c)	12
Section 316(a)	13
Section 502	13
Section 512(b) (10)	14
Appendix B	15
Opinion of the Court of Appeals	15
Appendix C	23
Judgment	23

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CROSBY VALVE & GAGE COMPANY
(Formerly Crosby Steam Gage & Valve Company),
Petitioner,
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT.

Petitioner, Crosby Valve & Gage Company, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the First Circuit entered in the above-entitled case on June 21, 1967.

Opinions Below.

The opinion of the Tax Court of the United States holding in favor of respondent is reported at 46 T.C. No. 66, and is reprinted in the Record Appendix. The opinion of the Court of Appeals is reported at F. 2d , and is reprinted in Appendix B hereto.

Jurisdiction.

The judgment of the Court of Appeals was entered on June 21, 1967. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

Question Presented.

May a business corporation be denied a deduction for a charitable contribution on the sole ground that the recipient, a charitable foundation, owns all of the stock of the business corporation?

Statutes and Rules Involved.

The statutory provisions involved are §§ 170(a) and (b)(2), 301(a) and (c), 316(a), 502 and 512(b)(10) of the Internal Revenue Code of 1954.

Statement of the Case.

The Court of Appeals for the First Circuit, affirming the decision of the Tax Court, decided that charitable contributions made by a business corporation, the petitioner, to a charitable foundation were not deductible on the sole ground that said foundation owned all of petitioner's stock. Even though substantial dividends were paid to said stockholder during the period in issue, the Court held that the contributions, too, must be treated as dividends.

During the calendar year 1954, petitioner made four assignments of bonds to charitable organizations qualified for exemption under § 501(a) of the Internal Revenue Code of 1954. Three of the assignments were made to The Stone Charitable Foundation, Inc., a charitable corporation

of the type described in § 501(c)(3), and the fourth assignment was made to The Stone Charitable Foundation, a charitable trust. Each of the assignments was authorized by petitioner's board of directors as a charitable gift, reported by the recipients as a charitable donation, and deducted by petitioner as a charitable contribution under § 170(a). Despite the identical mechanics and intention behind all four assignments, the respondent and the Tax Court allowed a deduction for the contributions to the charitable trust alone, and the Court of Appeals for the First Circuit affirmed the decision of the Tax Court. The Court of Appeals refused to treat the assignments to The Stone Charitable Foundation, Inc., as charitable contributions on the sole ground that, because the recipient was the sole stockholder of petitioner, no assignment to it could be a charitable contribution even though, during the period in issue, petitioner paid dividends of $300,000 to its sole stockholder and deducted total charitable contributions of only $32,003.50 (of which $4,576.25 was given to charities other than The Stone Charitable Foundation, Inc.).

Reasons for Granting the Writ.

The decision below is of vast importance to the public, due to the continuing financial dependence of public charities on charitable contributions in general, and charitable foundations, in particular. The decision strikes a hard blow at the long-standing Congressional policy of encouraging charitable donations.

The decision below raises an important question concerning the interpretation of certain provisions of the Internal Revenue Code of 1954 dealing with the treatment of charitable foundations, which provisions have not been but should be interpreted by this Court.

The decision below departs from the long-accepted and widely followed separate-entity doctrine of corporate and tax law.

In view of the fact that an appeal has been taken to the Court below in another tax case involving essentially the same issue, *Knapp Bros. Shoe Manufacturing Co.* v. *United States,* 265 F. Supp. 133 (D. Mass. 1967), this writ should be granted to protect the rights of this petitioner at least until the other tax case has been decided.

Summary of Argument.

This argument is divided into four parts to conform to the four reasons, above noted, for granting the writ.

Part I argues that the decision below should be reviewed since it has an impact on the public and not just the petitioner, and that the impact is one of a continuing nature. Charities today are financially dependent on both public and private foundations for donations. This dependence has been recognized by Congress, which, through legislation, has fostered gifts to charity. Any attempt by a lower Court to interfere with Congressional policy should be reviewed and resisted by this Court.

Part II argues that the Court below has erroneously interpreted and misapplied sections of the Internal Revenue Code of 1954 dealing with charitable contributions by feeder organizations. Due to the continuing importance to the public, as stated in Part I above, this Court should indicate how the sections of the Internal Revenue Code in issue should properly be applied.

Part III argues that the Courts have long recognized the separate-entity doctrine of corporate and tax law. A tax-exempt foundation and a taxable business corporation are two separate and distinct entities, and should be

treated as separate entities. By misapplying sections of the Internal Revenue Code to the case at bar, the Court below has violated this long-honored doctrine. No such erosion should be permitted.

Part IV argues that the Court of Appeals for the First Circuit is to hear the appeal in another tax case involving essentially the same issue, *Knapp Bros. Shoe Manufacturing Co., supra.* Should the decision by the Court below be inconsistent with the decision in the case at bar, this petitioner would be foreclosed from perfecting its rights on review if this writ is not granted.

Argument.

I.

The decision of the Court below should be reviewed since it deals with a problem that is of great concern today to the public. Because of the importance which this country attaches to private philanthropy, the federal government has long made generous provision for tax exemptions for charitable organizations and tax deductions for the contributors to such organizations. Since the federal tax laws in this way encourage and, in substantial measure, finance private charity, both Congress and the Treasury Department periodically re-examine the character of these laws and their impact upon the public. In fact, the Treasury Department periodically issues reports on private foundations. The Treasury Department Report on Private Foundations, which was submitted to the Chairman, Committee on Finance, United States Senate, and the Chairman, Committee on Ways and Means, House of Representatives, on February 2, 1965, reported that a 1964 survey of 14,850 foundations revealed that the investment policy of 10,990 of said foundations was 50% or more donor influenced

(p. 85). Accordingly, it can safely be stated that problems dealing with donor-oriented foundations are by no means restricted to the petitioner in the case at bar but concern over 10,000 other private foundations. The continued financial dependence of public charities on these foundations cannot be underestimated. The decision in the Court below raises doubt about a vast number of past and future transactions and subverts the obvious Congressional policy of fostering charitable gifts. Congress, which has long permitted donors to make deductible contributions to charities which they control, has never seen fit to legislate that donors cannot make deductible contributions to charities which control them. If there is to be any change in policy, the change should be made by Congress and not by a lower Court. To permit the Treasury Department, the Court below or any other lower Court to diminish the importance of the private foundation or to restrict gifts to private foundations from business corporations owned by such foundations would result in a serious and deleterious impact on private philanthropy and the welfare of the general public. This matter is of sufficient national importance to require a hearing by this Court.

II.

In denying the charitable contributions in the case at bar, the Court of Appeals for the First Circuit erroneously misinterpreted and misapplied sections of the Internal Revenue Code of 1954 dealing with charitable contributions by feeder organizations. The opinion of the Court below placed considerable weight on the statutory treatment and legislative background dealing with unrelated business income of charitable organizations, and cited § 512(b)(10) of the Internal Revenue Code of 1954 as authority for denying a charitable deduction to petitioner, a feeder organization.

Exempt organizations engaged in unrelated business activities look to §§ 511 to 515 of the Internal Revenue Code for their general tax provisions and to § 512(b)(10) for their charitable contribution deduction. Any limitation by a feeder's entitlement to a charitable contribution must be found in § 502. There does not appear to be any such limitation there. On the contrary, feeders, like any other business corporations, look directly to § 170 for their charitable-contribution deduction. Since §§ 511 to 515, inclusive, as stated above, deal only with exempt organizations and petitioner is not an exempt organization, it is elementary that petitioner must look to § 170(b)(2) for its deduction for charitable contributions and not to § 512(b)(10).

The law clearly allows taxpayers to contribute stock in closely held corporations to private foundations. The law also clearly allows business corporations to make charitable contributions to private foundations. The Court below said, however, that, if taxpayers give stock control of a business corporation to a private foundation, contributions thereafter by the business corporation to the private foundation will be treated as dividends. This interpretation certainly interferes with Congressional policy.

The Court below treated the payments in issue as nondeductible dividends under § 316 of the Internal Revenue Code without correctly interpreting that statute. A dividend is defined by § 316(a) as a distribution of property made by a corporation to its shareholders to the extent of available earnings and profits. The operative section taxing such distributions is § 301, which clearly refers only to distributions made by a corporation "to a shareholder with respect to its stock." Since petitioner separately paid substantial dividends of $300,000 during the period in issue to its charity-shareholder, and since petitioner made the charitable assignments in order to effectuate a policy of

giving the maximum amount to charity that good business judgment would allow, it is evident that the assignments were not made to the "shareholder in his capacity as such" or "with respect to its stock," and that the Court below has misinterpreted § 316.

The Court below, in applying the wrong section of the Code relating to charitable contributions and in misinterpreting the section of the Code relating to dividends, has unduly denied a charitable contribution to petitioner, but of greater significance has attempted to legislate, and by so doing has usurped the function of Congress. This Court should grant the writ in order to prevent a distortion of the proper roles of administrative agencies and Courts in implementing Congressional legislation.

III.

The decision of the Court of Appeals conflicts with the long-honored doctrine that a parent corporation and a subsidiary corporation are separate and distinct entities, and proper recognition must be given to transactions between said corporations. This doctrine was well summarized by Judge Waterman in the case of *Kraft Foods Co.* v. *Commissioner of Internal Revenue,* 232 F. 2d 118 (2d Cir. 1956), a case in which the Court of Appeals reversed the Tax Court and held that a solely owned subsidiary could not be denied an interest deduction with respect to interest on its debenture held by its parent merely because the parent controlled the subsidiary. Judge Waterman recognized the propriety of closely scrutinizing parent-subsidiary transactions to ascertain their true economic and legal significance, but thereafter placed the role of such subsidiary in proper perspective:

> "However, it is one thing to say that transactions between affiliates should be carefully scrutinized and

sham transactions disregarded, and quite a different thing to say that a genuine transaction affecting legal relations should be disregarded for tax purposes merely because it is a transaction between affiliated corporations. We think that to strike down a genuine transaction because of the parent-subsidiary relation would violate the scheme of the statute and depart from the rules of law heretofore governing inter-company transactions.

"In a broad economic sense, of course, it is of limited significance what form a sole stockholder's investment in a wholly-owned corporation takes. That is equally true of any transaction or arrangement between affiliates, whether it be an operating contract, a sale, a lease, or a payment of interest or dividends. But the law generally and the applicable tax law deliberately, through its insistence on taxing affiliates separately, affords significance to and honors the type of investment chosen. In consequence, all legitimate and genuine corporation-stockholder arrangements have legal—and hence economic—significance, and must be respected in so far as the rights of third parties, including the tax collector, are concerned." Id., at 124.

It is submitted that the subtle erosion of a statutory or legal doctrine is sufficient ground for granting this writ.

IV.

On March 14, 1967, Judge Ford, of the United States District Court for the District of Massachusetts, allowed deductions for charitable contributions in a tax case involving essentially the same issue. *Knapp Brothers Shoe Manufacturing Corp.* v. *United States,* 265 F. Supp. 133 (D. Mass. 1967). In that case the plaintiff's certificate of

incorporation provided that "no part of its income or property shall enure to the private benefit of any stockholder, director, or officer, or any individual or corporation other than New York University." The certificate of incorporation further provided that the profits or assets shall be paid solely to New York University. Petitioner accordingly made distributions to New York University and subject to the 5% limitation claimed deductions for charitable contributions to said New York University, in essence its sole stockholder. Judge Ford allowed the deductions. This decision has been appealed to the Court of Appeals for the First Circuit but has not yet been heard. It is submitted that it would be an injustice to this petitioner to foreclose its rights of review until the Court of Appeals has decided the *Knapp* appeal.

Conclusion.

For the reasons stated above, it is respectfully submitted that a writ of certiorari should issue to the United States Court of Appeals for the First Circuit so the important questions relating to tax-exempt foundations and charitable contributions may be heard.

Respectfully submitted,

MATTHEW BROWN,
Attorney for Petitioner.

ALFORD P. RUDNICK,
JACK H. CALECHMAN,
PETER GENS,
Of Counsel.

Dated Boston, Massachusetts,
September 18, 1967.

Appendix A.

Statutes and Rules Involved.

INTERNAL REVENUE CODE OF 1954.

SEC. 170. CHARITABLE, ETC., CONTRIBUTIONS AND GIFTS.

(a) ALLOWANCE OF DEDUCTION.—

(1) GENERAL RULE.—There shall be allowed as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year. A charitable contribution shall be allowable as a deduction only if verified under regulations prescribed by the Secretary or his delegate.

. . . . . .

(b) LIMITATIONS

. . . . . .

(2) CORPORATIONS.—In the case of a corporation, the total deductions under subsection (a) for any taxable year shall not exceed 5 percent of the taxpayer's taxable income computed without regard to—

(A) this section,

(B) part VIII (except section 248),

(C) any net operating loss carryback to the taxable year under section 172, and

(D) section 922 (special deduction for Western Hemisphere trade corporations).

Any contribution made by a corporation in a taxable year (hereinafter in this sentence referred to as the "contribution year") in excess of the amount deductible for such year under the preceding sentence shall be deductible for each of the 5 succeeding taxable years in order of time, but only to the extent of the lesser of the two following amounts:

(i) the excess of the maximum amount deductible for such succeeding taxable year under the preceding sentence over the sum of the contributions made in such year plus the aggregate of the excess contributions which were made in taxable years before the contribution year and which are deductible under this sentence for such succeeding taxable year; or (ii) in the case of the first succeeding taxable year, the amount of such excess contribution, and in the case of the second, third, fourth, or fifth succeeding taxable year, the portion of such excess contribution not deductible under this sentence for any taxable year intervening between the contribution year and such succeeding taxable year.

SEC. 301. DISTRIBUTIONS OF PROPERTY.

(a) IN GENERAL.—Except as otherwise provided in this chapter, a distribution of property (as defined in section 317 (a)) made by a corporation to a shareholder with respect to its stock shall be treated in the manner provided in subsection (c).

. . . . . .

(c) AMOUNT TAXABLE.—In the case of a distribution to which subsection (a) applies—

(1) AMOUNT CONSTITUTING DIVIDEND.—That portion of the distribution which is a dividend (as defined in section 316) shall be included in gross income.

(2) AMOUNT APPLIED AGAINST BASIS.—That portion of the distribution which is not a dividend shall be applied against and reduce the adjusted basis of the stock.

(3) AMOUNT IN EXCESS OF BASIS.—

(A) IN GENERAL.—Except as provided in subparagraph (B), that portion of the distribution which is not a dividend, to the extent that it exceeds the adjusted basis of the stock, shall be treated as gain from the sale or exchange of property.

(B) DISTRIBUTIONS OUT OF INCREASE IN VALUE ACCRUED BEFORE MARCH 1, 1913.—That portion of the distribution which is not a dividend, to the extent that it exceeds the adjusted basis of the stock and to the extent that it is out of increase in value accrued before March 1, 1913, shall be exempt from tax.

SEC. 316. DIVIDEND DEFINED.

(a) GENERAL RULE.—For purposes of this subtitle, the term "dividend" means any distribution of property made by a corporation to its shareholders—

(1) out of its earnings and profits accumulated after February 28, 1913, or

(2) out of its earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

Except as otherwise provided in this subtitle, every distribution is made out of earnings and profits to the extent thereof, and from the most recently accumulated earnings and profits. To the extent that any distribution is, under any provision of this subchapter, treated as a distribution of property to which section 301 applies, such distribution shall be treated as a distribution of property for purposes of this subsection.

SEC. 502. FEEDER ORGANIZATIONS.

An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under section 501 on the ground that all of its profits are payable to one or more organizations exempt under

section 501 from taxation. For purposes of this section, the term "trade or business" shall not include the rental by an organization of its real property (including personal property leased with the real property).

SEC. 512. UNRELATED BUSINESS TAXABLE INCOME.

. . . . . .

(b) EXCEPTIONS, ADDITIONS, AND LIMITATIONS.—The exceptions, additions, and limitations applicable in determining unrelated business taxable income are the following:

. . . . . .

(10) In the case of any organization described in section 511 (a), the deduction allowed by section 170 (relating to charitable etc. contributions and gifts) shall be allowed (whether or not directly connected with the carrying on of the trade or business), but shall not exceed 5 percent of the unrelated business taxable income computed without the benefit of this paragraph.

Appendix B.

United States Court of Appeals
For the First Circuit

No. 6872.

CROSBY VALVE & GAGE COMPANY
(FORMERLY CROSBY STEAM GAGE & VALVE COMPANY),
PETITIONER,

v.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

Before ALDRICH, *Chief Judge,*
McENTEE and COFFIN, *Circuit Judges.*

Jack H. Calechman, with whom *Alford P. Rudnick* and *Peter D. Gens* were on brief, for petitioner.

Albert J. Beveridge, III, Attorney, Department of Justice, with whom *Mitchell Rogovin,* Assistant Attorney General, *Lee A. Jackson* and *Harry Baum,* Attorneys, Department of Justice, were on brief, for respondent.

June 21, 1967.

COFFIN, *Circuit Judge.* Is a business corporation, wholly owned by a charitable foundation, entitled to a charitable

deduction for property (in this case equity in bonds) turned over without consideration to its parent? This is the issue posed by this petition to review a decision of the Tax Court.

The Tax Court held that the transfers to the foundation were not deductible. It placed primary emphasis on its syllogism that (1) "charitable contribution" is synonymous with "gift"; (2) a gift proceeds from a "detached and disinterested generosity"; and (3) since the transfers in this case were the result of the foundation's control over the corporation they were motivated by legal duty to its sole stockholder, and not by disinterested generosity. While agreeing with the holding of the Tax Court, we think it necessary to register our disagreement with the majority's emphasis upon a purely charitable motive as a prerequisite for a deductible charitable contribution. Were the deductibility of a contribution under section 170(c) of the Internal Revenue Code of 1954 to depend on "detached and disinterested generosity", an important area of tax law would become a mare's nest of uncertainty woven of judicial value judgments irrelevant to eleemosynary reality. Community good will, the desire to avoid community bad will, public pressures of other kinds, tax avoidance, prestige, conscience-salving, a vindictive desire to prevent relatives from inheriting family wealth—these are only some of the motives which may lie close to the heart, or so-called heart, of one who gives to a charity. If the policy of the income tax laws favoring charitable contributions is to be effectively carried out, there is good reason to avoid unnecessary intrusions of subjective judgments as to what prompts the financial support of the organized but non-governmental good works of society.

Such cases as *DeJong* v. *Commissioner,* 309 F.2d 373, 376 (9th Cir. 1962) and *Channing* v. *United States,* 4 F.

Supp. 33, 34 (D. Mass.), *aff'd. per curiam,* 67 F.2d 986 (1st Cir.), *cert. denied,* 291 U.S. 686 (1933), do not make such intrusion necessary. These cases dealt with payments in the nature of tuition for educational services rendered to taxpayers' children.[1] As such, the payments were purchases of services rather than net additional resources made available without restriction to charities for their purposes. Thus, the transfers were clearly "personal . . . or family expenses", Int. Rev. Code of 1954, § 262, rather than "gifts or charitable contributions".

What is confusing in such cases and in the Tax Court's opinion is reference to the law excluding from the gross income of individuals the value of property acquired by gift. See *Commissioner* v. *Duberstein,* 363 U.S. 278 (1960). For in such cases it is important to scrutinize the motive of the transferor, to prevent the disguising of compensation for services rendered, *e.g., Commissioner* v. *LoBue,* 351 U.S. 243 (1956), and allow exclusion only of property given from "a detached and disinterested generosity", *Robertson* v. *United States,* 343 U.S. 711 (1952). While the law recognizes gifts to individuals and organizations other than charities, it does not so positively encourage them. And, particularly when the transfer of property without consideration is made beyond a family setting and in a business atmosphere, it is properly subjected to a searching inquiry as to the real motivation of the transferor.

But in the case of a contribution to a charitable organization, the law's policy finds charity in the purposes and

[1] *See also Jefferson Mills, Inc.* v. *United States,* 259 F. Supp. 305 (D. Ga. 1965), *aff'd. per curiam,* 367 F.2d 392 (5th Cir. 1966), where the government took precisely the opposite position to that which it argues here, unsuccessfully arguing that "payments made to support a local school system, regardless of the business motive or benefit received by the donor corporation, are deductible only as charitable contributions and not as business expenses." 259 F. Supp. at 312.

works of the qualifying organization, not in the subjective intent of the contributor. On this issue we agree with the concurring and dissenting judges of the Tax Court.

We affirm on the alternative ground for the Tax Court's decision—that there is "no reason for a difference in tax treatment merely because the income was earned by a wholly-owned subsidiary rather than directly by the tax exempt organization."

As this language indicates, there is no specific statutory provision which compels but one result. The transfers in this case fall equally within the literal meanings of "charitable contribution" under section 170(c) of the Internal Revenue Code, and of "dividend" under section 316(a).[2]

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[2] Section 170(c) reads in relevant part as follows:

"(c) *Charitable Contribution Defined.*—For purposes of this section, the term 'charitable contribution' means a contribution or gift to or for the use of—

* * *

"(2) A corporation, trust, or community chest, fund, or foundation—

* * *

"(B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children or animals;

"(C) no part of the net earnings of which inures to the benefit of any private shareholder or individual; and . . . ."

Section 316 reads in relevant part as follows:

"(a) *General Rule.*—For purposes of this subtitle, the term 'dividend' means any distribution of property made by a corporation to its shareholders—

* * *

"(2) out of its earnings and profits of the taxable year. . . . Except as otherwise provided in this subtitle, every distribution is made out of earnings and profits to the extent thereof, and from the most recently accumulated earnings and profits . . . ."

Neither provision provides a clue to resolving the problem, for the transfers in this case were admittedly made to a qualifying charity and were also a distribution of property by a corporation to its shareholder.

Therefore we are both permitted and impelled to seek guidance in the purposes sought to be achieved by Congress. We find the necessary clues in the statutory treatment and legislative background of the taxation of unrelated business income of charitable organizations. At the time of passage of the Revenue Act of 1950, one of the problems faced by Congress stemmed from the widespread and increasing involvement of charities in profit-making enterprise. The House Committee on Ways and Means stated its concern: "The tax-free status of these . . . organizations enables them to use their profits tax-free to expand operations, while their competitors can expand only with the profits remaining after taxes. . . ." H. Rep. No. 2319, 81st Cong., 2d Sess. 37 (1950).

The result of this concern was the passage of what are now sections 502 and 511-515 of the Internal Revenue Code of 1954. One of the purposes was to avoid unfair competition, not by denying an exemption to charitable organizations carrying on business activities unrelated to their mission, but by treating them the same as their noncharitable competitors. H. Rep. No. 2319, *supra*. This was accomplished by section 511, imposing a tax on "unrelated business taxable income (as defined in section 512)"; and section 512(b)(10), which specifically allows the charity a section 170 deduction from unrelated business income up to 5 percent of such income.

The statutes, therefore, made it clear that no longer was a charity-run business enterprise free from income taxation. But charities could give to charities up to 5 per cent of their unrelated business income and have the benefit of the charitable deduction. While the statute did not spe-

cifically proscribe a charity's claiming the deduction for income retained by itself, both Senate and House committee reports stated clearly that "the contribution, whether made by a trust or other exempt organization, must be paid to another organization to be allowable." H. Rep. No. 2319, *supra,* at 111; S. Rep. No. 2375, 81st Cong., 2d Sess. 109 (1950). This refinement is carried over into section 1.512(b)—1(g)(3) of the Treasury Regulations.

There remains the case, presented by that before us, of a business subsidiary of a charity which desires to claim the 5 per cent deduction for its contributions to its parent. A closely analogous situation was discussed in the House and Senate committee reports:

> "Some of the witnesses who appeared before your committee took the position that this unrelated business income should be taxed only if received by a subsidiary organization. However, it is difficult to see why a difference in tax treatment should be allowed merely because in one case the income is earned directly by an educational or charitable organization, while in the other it is earned by a subsidiary of such an organization. In both cases the income is derived from the same type of activities and disposed of in the same manner. Moreover, in most cases the business functions now carried on by subsidiaries could be transferred to the parent if the tax were applied only to the income of the subsidiaries."

H. Rep. No. 2319, *supra,* at 37; S. Rep. No. 2375, *supra,* at 29.

Whether the charity operates the business directly or through a subsidiary, the economic and competitive implications of allowing a deduction for income that in fact is retained by the charity would be the same. In each case,

either the charity would receive a greater return on its investment in its business than a non-charity, which could allow it to expand that business with less recourse to external financing, or the business itself would have a critical "cushion", allowing it to cut prices, increase services, etc., to the disadvantage of non-charity-linked competitors.[3]

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[3] For example, suppose a competing business corporation not owned by a charity (call it Hope Valve & Gage Co.) and the petitioner (Crosby Valve & Gage Co.) each has net earnings before taxes of $10,000,000, and each wishes to produce the maximum return to its stockholders. Then if Crosby can deduct 5% of its earnings by distributing that amount to its charitable sole stockholder and calling it a charitable contribution rather than a dividend, the result is as follows:

	Crosby	Hope
Net earnings (N):	$10,000,000	$10,000,000
Charitable deduction (D):	500,000	0
Taxable income (N-D):	9,500,000	10,000,000
Tax (T) [47% (N-D)—$5,500]:	4,459,500	4,694,500
Earnings available for distribution to stockholders (N-T):	$ 5,540,500	$ 5,306,500

If, on the other hand, Crosby's charitable stockholder is content with the same return earned by its competitor, Crosby has the option of retaining the difference of $234,000 in earnings to finance competition in services, etc., or of cutting prices to a level that produces $9,577,235 in net earnings, with the following effect:

	Crosby	Hope
Net earnings:	$ 9,577,235	$10,000,000
Charitable deduction:	478,862	0
Taxable income:	9,098,373	10,000,000
Tax:	4,270,735	4,694,500
Earnings available for distribution to stockholders:	$ 5,306,500	$ 5,306,500

In either case, Crosby would have precisely the competitive advantage that Congress sought to prevent. Furthermore, if Hope chose to contribute any amount to charity, even to Crosby's parent charity, that amount would reduce the amount available to Hope's stockholders and thus would increase the disparity.

Petitioner argues that disallowing the deductions in this case would place it in a worse position than competitors, since they could claim a deduction for contributions made to its parent charity while it could not. But petitioner can take full advantage of the deduction by contributing to any *other* charity. Its universe is decreased by only one member. Moreover, were petitioner's deductions to be allowed it would be able to make a partially tax-free distribution of its earnings to its sole shareholder—something denied to its competitors and clearly contrary to the approach to the tax treatment of "feeder" organizations taken by section 502 of the Internal Revenue Code.[4] In sum, we conclude that the transfer in this case must be treated as a non-deductible dividend under section 316.

We add that our holding is not based on the intention or *bona fides* of the petitioner. Petitioner has argued that its purposes could have been accomplished using other techniques and that form should be disregarded. Apart from pointing out that, as individuals now interested in petitioner's claim have elsewhere demonstrated to their advantage, *Stone* v. *Commissioner,* 360 F.2d 737 (1st Cir. 1966), form is not so easily disregarded in this field, we resist making further generalizations unnecessary to the decision of this case.[5]

Affirmed.

---

[4] "An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt under section 501 on the ground that all of its profits are payable to one or more organizations exempt under section 501 from taxation . . . ."

[5] In particular we would not wish any unnecessary generalizations that we might make to affect our consideration of, or decision in *Knapp Bros. Shoe Mfg. Co.* v. *United States,* 265 F. Supp. 133 (D. Mass., 1967), the appeal in which has not yet been heard.

Appendix C.

Judgment.

June 21, 1967.

This cause came on to be heard on petition for review of a decision of the Tax Court of the United States, and was argued by counsel.

Upon consideration whereof, It is now here ordered, adjudged and decreed as follows: The decision of the Tax Court is affirmed.

By the Court:

/s/ ROGER A. STINCHFIELD

Clerk.

Enter:

/s/ ALDRICH, Ch. J.